Fourth Quarter 2011

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11 Top Financial Planning Tips For The Rest Of 2011

How are you faring financially so far in 2011? Now is a good time to assess your situation and consider changes. Consider these 11 tips.

1. Spend only what you can afford. It seems simplistic, but many people, even those with substantial incomes, ignore this basic financial principle. If you have more money going out than you have coming in, it's a recipe for eventual disaster. To get things in balance may require trimming your spending or earning more. Are you being paid what you're worth? Can you get an additional, part-time job? Do you have entrepreneurial ideas that could bring in extra income? Making a few thousand dollars more each year could add up to a significant sum over your lifetime.

2. Make a budget and stick to it. This tip dovetails with the previous one. Regardless of how much you earn, it's important to know what you're spending and where the money goes. Track your expenses by keeping credit card receipts and noting cash payments. You may be surprised at how much you spend on certain items and monitoring your outlays could help you find easy ways to economize.

3. Avoid mounting credit card debt. One of the worst financial traps is to make large purchases on credit and then fail to pay off the full amount each month. Despite recent legislation to reform rules on credit cards, your issuer can still impose double-digit interest rate charges on unpaid balances, sending your debt higher and higher and making it increasingly difficult to retire. If you have a large balance or two, consider consolidating your debt and putting away your plastic until you catch up.

4. Pay yourself first. This idea also needs to be coordinated with previous tips. But the main point is to set aside perhaps 5% to 10% of your income on a regular basis—before it gets spent. It may help to have the money automatically deducted from your paycheck and deposited into a separate account.

5. Invest your savings. It's not enough just to save money; you also have to put it to work for you. It's important to have an investment plan that considers your savings goals, when you'll need the money—for your kids' education, your retirement, or another objective—and how much investment risk you're comfortable taking. We can help you devise and implement an effective portfolio strategy.

6. Maximize employment benefits. Taking advantage of on-the-job benefits such as employer-sponsored health, dental, and life insurance could mean substantial savings. If your company offers flexible spending accounts, you can arrange to use pre-tax dollars to pay for unreimbursed medical or dental expenses—and save as much as a third on those outlays.

7. Salt away money in retirement plans. Most employers let you participate in a 401(k) plan or another tax-favored retirement account.

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Default Would've Been Worse Than U.S. Downgrade

Officials of every political persuasion have been quick to blame each other for Standard & Poor's decision to cut the U.S. Treasury's credit rating. And indeed, S&P laid the blame on both Congress and the White House for coming up with a spending compromise that "falls short of the amount that we believe is necessary." Yet while Washington failed to strike a deal sufficient to maintain the United States' top-tier borrowing status, consider how much worse it would have been if they'd made no deal at all.

Until Congress agreed to let the government borrow another $2.4 trillion, the Treasury was facing the prospect of having to pick which of its obligations to honor. Had that happened, S&P would likely have considered the United States to be in "selective default," effectively dropping its debt rating all the way from AAA to D. That would have made the recent downgrade look merciful by comparison. Most bond funds and all money market funds that currently own Treasury securities would have had to sell their holdings. And U.S. banks, which own $1.68 trillion in Treasuries—more Treasury debt than the Chinese government has—would have suffered crippling losses.

Congress and the White House managed to put aside their differences long enough to dodge that fatal bullet. While that may not be praiseworthy, the time for pointing fingers has passed.

Robert J. Pyle, CFP, CFA

Correction Creates Buying Opportunity

The stock market's midsummer swoon took investors on a harrowing ride, culminating in several days of triple-digit losses, a few days of triple-digit gains and an overall performance that, in the process, pushed the Dow Jones Industrial Average into negative territory for the year. The reasons behind the downturn were many, but largely focused on the following:

- Washington legislators lack of unity sorely worried investors. Congress and the administration argued and dithered for weeks before finding an eleventh-hour, short-term fix to the nation's deepening long-term debt woes.
- Rating agency Standard & Poor's responded by downgrading U.S. government debt (from AAA to AA+) for the first time in history.
- And much of the economic data released in the days before the market's roller coaster ride not only reinforced the fact that the current recovery is feeble but also fed fears that a double-dip recession could be on the horizon.

While investors of all stripes endured paper losses amid the downturn, the decline gave rise to good news for those with cash in reserve and a long-term investment horizon of five years or more. Stocks, as represented by the Standard & Poor's 500 index, are now selling at levels not seen since the market meltdown in the autumn of 2008. What's more, dividend yields on the shares of many high-quality, well-established corporations now compare favorably to the scant yields on 10-year Treasury securities.

Whether you are investing for retirement or a child's college education, or you would simply like to build wealth for an undetermined long-term goal, market downturns of this magnitude create investment opportunities to purchase stock at prices that are typically available only once every few years, though past performance is no guarantee of future success.

Indeed, there's no near-term guarantee that the summer market troubles won't continue into 2012. After all, Washington politicians have yet to find a solution to the damaging debt crisis, another downgrade of U.S. government credit by S&P or another ratings agency remains a possibility (though at this juncture seems unlikely), and few seasoned market observers believe the country's economic troubles will reverse course soon. Unemployment remains very high and consumer confidence is shaky.

The best advice now may be to revisit your investing plan and overall strategy to identify opportunities that have emerged that could help you achieve your long-range objectives. If the market downturn has been unsettling for you—as it has been for almost everyone—we could also revisit the risk exposure in your portfolio to ensure that it fits your personal comfort level. ●

Modern Portfolio Theory Is Alive And Well

For more than 50 years, Modern Portfolio Theory, or MPT, had been an article of faith for investors. The basic idea was that you could keep investment risk and reward in balance by choosing a diverse mix of assets. But then came the bear market of 2008 and 2009, during which nearly every kind of stock, bond, and most alternative investments plunged simultaneously. That led some analysts to pronounce Modern Portfolio Theory dead. What good is diversification, they asked, if everything sinks together?

But Modern Portfolio Theory never asserted that asset classes couldn't fall at the same time. Moreover, a look back over the past decade shows that investors who stayed diversified, continuing to rebalance during the downturn, enjoyed healthy returns. In fact, the market meltdown has proven a powerful validation of MPT.

MPT asserts that the best way to maximize returns while minimizing risk over the long term is to allocate your money among diversified classes of investments and periodically rebalance to keep the proportions in line with original targets.

MPT attempts to build a portfolio of asset types that won't necessarily move together in response to changes in the economy. The hope is that when one portion of your portfolio—say, large-cap stocks—falls in value, another part—commodities, for instance—will rise. Rebalancing lets you "buy low and sell high," because to keep allocations at proper levels you end up selling assets that have gained in value and buying others that have lost ground.

For long-term investors, one of the most distressing aspects of the 2008 economic crisis was the unprecedented way that nearly all asset classes—bonds, stocks, commodities—lost value at the same time. The notion that diversification ensures gains in some sectors despite losses in others seemingly lay in tatters. But diversification can't, in fact, ensure that outcome, and MPT never suggested it could. It can merely increase the likelihood of that result.

And even when, inevitably, there are times when every part of a portfolio loses

How A Solo 401(k) Plan Gives You An Edge

Do you run your business as a sole proprietor? For years, the options for tax-advantaged retirement plans for one-person outfits were relatively narrow, restricted to specialized small-business plans such as simplified employee pensions (SEPs). But recent legislative changes have made it possible for sole proprietorships to use the same type of retirement vehicle—the 401(k) plan—favored by bigger companies. A special "solo 401(k)" may provide a distinct advantage over comparable retirement options, enabling you to salt away considerably more money for the future.

People who work for an employer offering a 401(k) plan have the opportunity to direct part of their salary into a personal retirement account that they can invest in mutual funds or other basic vehicles. The money deferred to a 401(k) isn't taxed, and there are no capital gains taxes on investment profits. Instead, account owners pay income tax on money they withdraw during retirement. Many corporations match a portion of employees' contributions.

There's an annual limit on how much can be contributed to a 401(k). For 2011, salary deferrals are capped at $16,500 ($22,000 for those age 50 or over). In addition, the total annual contribution for 2011 to a "defined contribution plan" such as a 401(k) or a SEP is generally limited to 25% of compensation or $49,000 ($54,500 for those 50 or older), whichever is less. If you're self-employed, the cap is 20% of what you earn, and the maximum compensation for these purposes is $245,000 in 2011.

Thanks to a recent change in pension laws, however, you now may be able to combine the annual deferral to a solo 401(k) with an employer's matching contribution so that the total going into your plan exceeds the normal percentage limit for defined contribution plans. For example, suppose you're 45 years old, self-employed, and earn $150,000 in 2011. If you contribute to a SEP in 2011, your contribution would be limited to 20% of $150,000, or $30,000. But if you establish a solo 401(k) plan instead, you may be able to save considerably more. First, you defer the employee's maximum $16,500 to the plan. Then, because you work for yourself, you can sweeten the deal with the maximum employer contribution of $30,000. Add the two together and you can contribute $46,500 to the plan this year.

The more you make, the more you can put into a solo 401(k), though you'll still be subject to the overall dollar limits of $49,000 or $54,500 that apply to defined contribution plans. Once your compensation reaches $162,500—20% of which is $32,500, the maximum you can add to the $16,500 individual contribution without exceeding the $49,000 cap—the comparative advantage of having a 401(k) instead of an SEP begins to decline. But you'd have to make the full $245,000 to be able to contribute as much to an SEP as to a 401(k).

How much more can you accumulate if you choose a solo 401(k)? It depends on the maximum contributions at your income level for a 401(k) compared with an SEP and how long you have until retirement. But if, for example, you're able to put away $15,000 more each year in a solo 401(k), you have 25 years to retirement, and you earn 8% annually on investments within the plan, you'll pile up an additional $1,143,549.

A solo 401(k) plan may also provide other benefits, including:

- The flexibility to put as much or as little as you choose into the plan each year. If your business is having an off year, you can reduce or suspend contributions until conditions improve.
- The possibility of taking loans or hardship withdrawals from the plan. If you borrow from your plan, you're effectively paying yourself back with interest.
- The ability to accept rollovers from other qualified retirement plans or traditional IRAs.

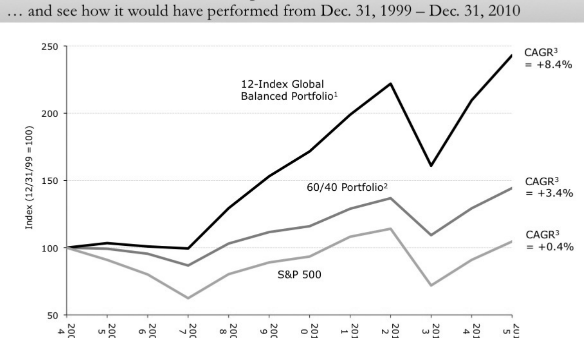
It used to be that the administrative cost of a 401(k) plan was too high for many sole proprietors, but fees have come down during the past decade. Typically, you'll now have to pay a set-up fee of about $100 plus ongoing expenses of a few hundred dollars a year. Keep in mind, though, that the benefits of a solo 401(k) really apply only to solo businesses. If your company employs other full-time workers, you must cover them as well and make employer contributions to their plans. But that requirement also applies to other types of retirement plans. If you run a successful one-person business and you want to build up your retirement plan balance as quickly as possible, a solo 401(k) could be your best option. ●

value for a while, MPT has great potential value. According to economist Fritz Meyer, a global portfolio using 12 asset classes managed according to MPT principles would have earned a compound annual growth rate of 8.4% during the volatile decade ending in 2010, compared with a 0.4% gain for a portfolio holding only stocks (represented by the Standard & Poor's 500 index).

Investment Strategy

Asset Allocation — An Example

… and see how it would have performed from Dec. 31, 1999 – Dec. 31, 2010



Past performance is not a guarantee of future results. An investment cannot be made directly in an index.
1 This hypothetical portfolio is composed of the 12 indexes referred to on the previous page, rebalanced to 1/12th of the portfolio at the end of each year.
2 This hypothetical portfolio is composed of the S&P 500 and Barclays US Aggregate Bond indexes referred to on the previous page, rebalanced to 60%/40%, respectively, at the end of each year.
3 Compound annual growth rate.

The secret is in the rebalancing, Meyer says, because disciplined rebalancing forces you to ignore macroeconomic considerations and keep emotions out of the process.

As we embark on another decade of economic and market uncertainty, we will continue to design portfolios that are properly diversified and regularly rebalanced, allowing MPT to work for you. ●

Don’t Succumb To Market Hysteria

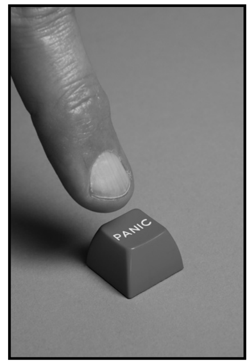
The market has been experiencing occasional panic attacks of late. But please avoid confusing the market’s gyrations with what’s actually going on in the real economy.

Stocks are overreacting to the unfortunate confluence of events: the downgrade of U.S. government bonds, some weaker than expected economic data, and the troublesome but manageable U.S. fiscal position. Along with sovereign debt issue threatening Europe, these factors are making the markets volatile.

Former Federal Reserve Board Chairman Alan Greenspan put it this way last Sunday on Meet The Press: “The United States can pay any debt it has because we can always print money to do that. So there is zero probability of default." Greenspan, who is not an oracle but who does years of experience in running the nation’s central bank, added that the downgrade “hit the self-esteem of the United States, the psyche."

While such a blow to our nation’s financial reputation cannot be dismissed and must be addressed, it’s also important to remember that there has been no real change in fundamentals driving the economy.

Improving economic data is plentiful. “The leading indicators point to slowly expanding economic activity in the coming months, according to the Conference Board’s most recent appraisal of the economy.



Weekly unemployment claims have tumbled from the April 2009 peak. The Bureau of Labor Statistics reported modest improvement in job growth for July. Layoffs of government workers have masked a jobs rebound in the private sector that looks fairly typical at this stage of an economic recovery. Economists cite renewed July-August auto hiring and a slower pace of state and local government layoffs ahead as reasons for optimism on initial claims for unemployment benefits.

Corporate earnings estimates keep climbing. Q2 nominal Gross Domestic Product is up 3.7%, while Q2 revenues on Standard & Poor’s 500-company were up a whopping 13.2%!

Earnings estimates for 2011 and 2012 rose again last week, continuing a trend of upward estimate revisions.

The S&P 500 is trading at 11 times 2011 earnings estimates. Investors right now can choose to buy the 10-year Treasury bond with a 2.3% yield or get a 2.2% dividend yield on the S&P 500 plus the potential upside on stocks. Will the relative value of stocks versus the 10-year Treasury bond ultimately be recognized by investors? History may not repeat itself. It’s possible. But using historical valuations and economic fundamentals to guide long-term investment decisions is prudent.

Hysteria is not new to investment markets. While it not easy to ignore the gyrations, our advice is to resist the panic by staying focused on fundamental factors that drive long-term values in securities markets. If you need to speak with us, we’re here for you. ●

Tips For The Rest Of 2011

(Continued from page 1)

With a 401(k), you can defer part of your salary on a pre-tax basis to your investment account, and your company may match a portion of your contribution. Outside of work, both traditional and Roth IRAs can also help you build your retirement nest egg.

8. Convert to a Roth IRA. One downside to traditional tax-deferred retirement accounts is that you’ll be taxed on distributions at a time when you may need all the income you can get. A Roth IRA, in contrast, doesn’t let you deduct contributions but can deliver tax-free payments in your 60s, 70s, and beyond. You can convert traditional plans to a Roth, paying tax on the converted amount now to avoid liability during retirement. And because a Roth IRA doesn’t require withdrawals, you’ll have the option of preserving the account to pass along tax-free income to your heirs.

9. Review insurance policies. Don’t make the mistake of being under or over-insured. For most people, the need for life and disability insurance is greatest during peak earning years and when there are children at home. But you’ll need adequate insurance coverage even during retirement.

10. Create or revise your will. Your will is the road map to your estate plan, and if you don’t have one, creating one is an absolute necessity. And an existing will may need to be updated, especially in light of the generous $5 million estate tax exemption ($10 million for married couples) available for 2011 and 2012. It’s also important to have a power of attorney document drawn up in case you are unable to manage your own finances.

11. Get organized. Finally, make sure to keep accurate records and know where they are located. Developing a system for monitoring your finances should prove helpful for years to come. ●

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